Supreme Court, U.S.
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No.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1995

TOSHIBA AMERICA MEDICAL SYSTEMS, INC.,

Petitioner,

vs.

OEC MEDICAL SYSTEMS, INC.,
formerly known as Diasonics, Inc.,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEAL OF CALIFORNIA, FIRST DISTRICT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether federal law governs the review of, and thereby establishes a nationwide uniform standard to review, an arbitral award entered in a Federal Arbitration Act arbitration or, instead, as the court below held, state law establishes the standard of review whenever the underlying contract contains a governing law clause?

2. Whether the Full Faith and Credit Clause, U.S. CONST. art. IV, §1 and the Due Process Clause, U.S. CONST., amends. V and XIV, require the courts of a state in which an arbitration sits to yield to its sister states' public policies, when those sister states have greater governmental interests as concerns the underlying events?

LIST OF PARTIES

The parties to the proceedings below were the petitioner, Toshiba America Medical Systems, Inc., and the respondent OEC Medical Systems, Inc., formerly known as Diasonics, Inc.

Toshiba America Medical Systems, Inc. is ultimately, indirectly owned by Toshiba Corporation, a publicly-held corporation. OEC Medical Systems, Inc. is a publicly-held corporation.

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PETITION FOR A WRIT OF CERTIORARI

Petitioner, Toshiba America Medical Systems, Inc. ("Toshiba America") respectfully prays for a Writ of Certiorari to review the judgment of the Court of Appeal of California, First District.

OPINIONS BELOW

The decision of the Supreme Court of the State of California denying Toshiba America's Petition for Review is not reported and is reprinted as Appendix A. The Opinion of the Court of Appeal, First District, First Division, State of California is not reported and is reprinted as Appendix B. The Judgment of the Superior Court, County of San Francisco,

State of California is not reported and is reprinted as Appendix C. The Arbitration Award is reprinted as Appendix D.

JURISDICTION

The Court of Appeal, First District, First Division, entered its judgment on October 25, 1995. Petitioner timely petitioned the Supreme Court of the State of California, which is the state court of last resort and which had discretionary authority to review the judgment, for review of the judgment. That court denied Toshiba America's Petition for Review on January 30, 1996. This petition is timely filed within ninety days of that denial. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. §1257.

CONSTITUTIONAL PROVISIONS INVOLVED

Article IV, Section 1 of the United States Constitution provides in pertinent part:

> Full Faith and Credit shall be given in each State to the public Acts, Records, and judicial Proceedings of every other State.

The Fifth Amendment to the United States Constitution provides in pertinent part:

> No person shall be . . . deprived of life, liberty, or property, without due process of law . . .

Section 1 of the Fourteenth Amendment to the United States Constitution provides in pertinent part:

> No State shall enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law . . .

STATEMENT OF THE CASE

Toshiba America sought to have the California courts review an arbitral award by applying the standard of review established under the Federal Arbitration Act, 9 U.S.C. §§1, *et seq.* Calling the issue of review "close," the California Superior Court applied the California state standard of review. Toshiba America appealed to the Court of Appeal and sought review under the federal standard of review. The Court of Appeal called state court application of a federal review standard a "slippery" approach to the law, refused to apply the federal standard and applied the California state standard on the ground that the general governing law clause in the parties' contract had chosen California law. (App. B)

The substantive issues to be reviewed on appeal yielded different results under the federal standard for review of an award than under the California state standard applicable to an intrastate arbitration not otherwise subject to the Federal Arbitration Act. Here, the underlying interstate and international transaction (an acquisition involving several hundred million dollars) falls squarely under the Federal Arbitration Act.

The difference between federal and state review, as applicable here, concerns how they deal with public policy issues. Under the California standard, as stated by the Court of Appeal, review may be had only if an award directly contradicts a California statute that establishes an explicit statutory right which the arbitrators reject. Under the federal standard, the court reviews public policy as set forth in both caselaw and statute, including the law of sister states which have the dominant governmental interest at stake. In the underlying case, the public policy issues dealt with the public policies of New York and other states. To state the obvious, no California statute creates New York or any other state's policy. The Court of Appeal therefore constructed a state law review standard under which New York's and other states' public policies would never be considered much less given their full faith and credit.

Specifically, the Court of Appeal held that it would not give public policy review (which under the federal review standard would have been given) to the public policies of affected sister states that forbid indemnifying a person for fraud, punitive damages and a host of intentional misdeeds. It dealt with an arbitrator, "interpreting" a contract covering the sale of a business, which contract contained a clause covering indemnity for only "ordinary course of business" claims resulting from the seller's pre-closing conduct. The seller contended that the buyer had to indemnify the seller for the seller's pre-closing fraud which the seller had allegedly perpetrated on third parties in New York, New Jersey and elsewhere.[1]

That arbitrator held, contrary to New York and other states' laws (which governed the conduct in question), that no public policy exists which limits claims for indemnity by the seller. The arbitrator then manifestly disregarded the law of New York, New Jersey and other states, expanded the contractual language and required that the seller be indemnified by the buyer for actual and punitive damages, even if adjudicated against the seller because of the seller's own fraud, deceit and intentional misconduct.

The arbitrator ruled that Toshiba America had to indemnify Diasonics for all claims arising from Diasonics' pre-closing acts, even claims not yet made, including Diasonics' fraud, all intentional misconduct of any kind whatsoever and punitive damages. (App. D, ¶4 & ¶9). The arbitrator further ruled that

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[1] Diasonics sold complex medical imaging equipment (MRI systems), usually at a price in excess of $1 million each, often to tax shelter promoters, in transactions involving sometimes labyrinthine financial relationships. Various Diasonics customers and others have asserted that Diasonics systematically engaged in a pattern of fraudulent sales practices in order to effect these transactions. While Diasonics (and Toshiba America) have denied the underlying allegations, for purposes of this litigation malicious fraud and intentional conduct must be assumed to have occurred, because the arbitrator ruled that Toshiba America must indemnify even such conduct.

no claim could ever be made that would contravene public policy. (*Id.*)

Toshiba America had shown that as a matter of substantive contract law it owed no such indemnity. Toshiba America further asserted that future claims against Diasonics, and even pending ones (because litigants could amend their claims against Diasonics and could conform their pleading to the proofs), could not be indemnified in the abstract. Rather, the determination of indemnity needed to await the disposition of the claim, at which time the parties could determine the nature of the claim, and then apply the contracts and public policy to such claims. To do otherwise would be irrational.

Toshiba America also argued that, if the contracts were to be construed as asserted by Diasonics, then the contracts would violate public policy. Also, because Diasonics did business nationwide and because the claimants could make (and had made) claims for transactions in multiple states, the public policies of the multiple states affected by the alleged torts concerning indemnity all needed to be taken into account. In general, public policy forbids indemnity for fraud, intentional misconduct and punitive damages. Thus, while the arbitral panel could declare that no such claims could be indemnified, it could not declare that indemnity must be provided for all such claims, for to do so would violate public policy of the States in which the alleged torts have been committed, which have the dominant governmental interest, and which forbid indemnity of fraudulent and intentional wrongdoing as an integral part of their scheme of justice. A blanket declaration of indemnity for all conduct of any kind would thus eviscerate the policies of the affected states.

REASONS FOR GRANTING THE WRIT

I.

Federal Substantive Law Governs Review Of The Arbitration Award

A. Federal Substantive Law Must Apply In Order To Ensure A Consistent, Rational Scheme For Arbitral Review Exists In Federal Arbitration Act Cases.

Federal arbitration law governs the arbitration of disputes affecting interstate commerce. Yet, as a procedural and judicial jurisdictional matter, review of arbitration awards rendered in Federal Arbitration Act arbitrations generally falls to the state courts. The states, of course, must apply substantive federal law to legal proceedings governed by federal law.

In the context of arbitration, this is especially critical, since the validity of an arbitral outcome governed by a federal scheme should not be dependent upon the vagaries of individual states' approaches to arbitration. It thus seems self-evident that federal law controlled the review of this arbitral award. Yet, the Court of Appeal erroneously labeled that concept "slippery" and rejected federal arbitration law in favor of state arbitration law.

It is beyond dispute that the transaction between Toshiba America and Diasonics constitutes interstate commerce and thus, federal substantive arbitration law must control the review of this arbitration award. *See* 9 U.S.C. §§1-16; *Brown v. Rauscher Pierce Refnes, Inc.*, 994 F.2d 775, 778 (11th Cir. 1993); *Cohen v. Wedbush, Noble, Cooke, Inc.*, 841 F.2d 282, 285 (9th Cir. 1988).

This Court has held that when transactions involve interstate commerce, the body of substantive law created by the Federal Arbitration Act preempts any state laws or policies to the contrary even if the agreement to arbitrate contains a choice of law provision. *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 115 S.Ct. 1212 (1995). *See Allied-Bruce Terminix Companies, Inc. v. Terminix International Co.*, 115

S.Ct. 834 (1995); *Moses H. Cone Mem. Hosp. v. Mercury Const. Corp.*, 460 U.S. 1, 24 (1983); *Cohen v. Wedbush, Noble, Cooke, Inc.*, 841 F.2d 282, 285 (9th Cir. 1988).

Furthermore, federal substantive law rather than state law governs the review of an arbitration award notwithstanding a choice of law provision or state law to the contrary. *Atlantic Aviation, Inc. v. EBM Group, Inc.*, 11 F.3d 1276, 1280 (5th Cir. 1994); *C.T. Shipping, Ltd. v. DMI (U.S.A) Ltd.*, 774 F. Supp. 146, 148-49 (S.D.N.Y. 1991); *Hilton Constr. Co. v. Martin Mechanical Contractors, Inc.*, 308 S.E.2d 830, 832 (Ga. 1983).

Despite these well settled principles, the California State courts, in a case involving interstate commerce, chose to ignore the federal substantive law created by the Federal Arbitration Act and instead only applied California substantive law. They did so by contorting this Court's ruling that state courts, when handling litigation involving an arbitration, can apply state *procedural* rules in disposing of the case.

In *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University*, 489 U.S. 468 (1989), this Court held simply that state courts, in reviewing arbitral issues, can apply state procedural rules to their review of the legal issues raised. *Id.* at 476. Thus, in *Volt*, this Court held merely that California's courts could apply state rules governing stays in multi-party litigations, some of which involved agreements to arbitrate, not that California substantive law governed the review of arbitration awards rendered in interstate disputes arising from California contracts.

However, the California Court of Appeal in rendering their decision rejected the application of substantive federal law and stated that the distinction between substantive issues and procedural issues is "without significance." (App, B, pg. 4)

The substantive-versus-procedural-law distinction often arises in our federal legal system, whereby procedures differ between federal and state tribunals, both of whom can be called upon to decide federal and state substantive

questions. Plainly, though, the issues raised here concern substance and not procedure. In short, federal substantive arbitration law must govern.

The Court of Appeal, in direct contravention of these well established principles, instead held that California substantive law governed review of the arbitral award (App, B at 4), thus creating a situation where there is direct conflict between the federal decisions and the Court of Appeal's decision. The Court of Appeal erroneously held that the parties' selection of California law as the law that governed the Asset Purchase Agreement meant that state law governs the review of the arbitral award.

B. This Court Granted Certiorari On This Issue For The Current Or Next Term.

This Court on January 5, 1996, granted certiorari in *Doctor's Associates, Inc. v. Casarotto*, 116 S.Ct. 690 (1996) (Docket No. 95-559), a case with a similar question presented as in our situation. In *Doctor's Associates*, this Court will review the Supreme Court of Montana's decision that a Montana arbitration statute is not preempted by the Federal Arbitration Act. As the California courts did here, the Montana Supreme Court erroneously interpreted *Volt* to mean that an area covered by federal substantive arbitration law can be addressed instead by state arbitration law. *Casarotto v. Lombardi*, 901 P.2d 596 (Mont. 1995), *cert. granted,* 116 S.Ct. 690 (1996). As explained above, *Volt* merely held that states can apply its procedural rules to arbitration proceedings. It is obvious that the issue of whether the federal substantive law created by the Federal Arbitration Act preempts state law to the contrary is an important question that this Court must resolve.

Thus, this Court should grant Toshiba America's Petition for a Writ of Certiorari to review this unsettled question presented by Toshiba America. In the alternative, this Court should reserve its decision on this petition pending its determination of *Doctor's Associates*.

II.

A Uniform Federal Standard Is Necessary To Uphold The "Full Faith And Credit" and "Due Process" Due Sister States' Public Policies

Based upon a flawed application of state substantive arbitration law which resulted in the California Court of Appeal applying a standard of review other than the federal standard, the California Court of Appeal also refused to consider the full faith and credit due New York, New Jersey and other states' laws and the requirements of due process.

Federal substantive law requires that an arbitration award be vacated if its enforcement is contrary to public policy. *Brown v. Rauscher Pierce Refnes, Inc.*, 994 F.2d 775, 778 (11th Cir. 1993); *Cohen v. Wedbush, Noble, Cooke, Inc.*, 841 F.2d 282, 285 (9th Cir. 1988); *Delta Air Lines v. Air Line Pilots Ass'n Intern.*,861 F.2d 665, 671 (11th Cir. 1988), *cert. denied*, 493 U.S. 871 (1989); *USPS v. NAIC*, 847 F.2d 775 (11th Cir. 1988). Furthermore, as a matter of federal substantive law, an arbitral award must be set aside when it manifestly disregards the law. *George Day Const. Co. v. United Brotherhood of Teamsters*, 722 F.2d 1471 (9th Cir. 1984).

In general, as a matter of public policy, states hold that indemnity cannot be had for fraud, intentional misconduct or punitive damages. Because the claims against Diasonics arise from transactions spanning the United States, and because the award purports to declare Diasonics' rights with respect to claims not yet even asserted by customers and third-parties, a declaration that every conceivable claim that might be made against Diasonics must be indemnified by Toshiba America of necessity contravenes public policy. Thus, such a declaration is fatally flawed and must be set aside under federal law.

We deal here with a private indemnity contract which, as "interpreted" by the arbitrator, would operate to have one private person relieve another from governmentally imposed punishment for egregious wrongdoing. Just as public policy in most states would forbid a private person from obligating

himself to serve the sentence of another meted out as governmental punishment, vouchsafing private commitments to protect a private person from the yet-to-be-assessed consequences of his wrongdoing and from not-yet-imposed punitive actions intended to deter his future conduct, undermines, indeed eviscerates, the public policy that mandates holding the wrongdoer personally accountable. As regards such subjects, private indemnity contracts, as a matter of public policy itself, cannot even operate as broadly as insurance contracts might since the latter operate in a governmentally regulated environment in which insurance serves governmentally authorized social objectives while the former operate to serve purely private interests.[2]

Indemnifying a tortfeasor for punitive damages, or for its intentional misconduct and its fraud, clearly contravene the laws and public policies of the states in which the alleged misconduct occurred as of the time of the arbitration (New York and New Jersey).

Federal law mandates that California yield to its sister states' public policies which forbid indemnity, in order to impose retribution, punishment and deterrence for fraud and intentional misconduct committed contrary to their governmental interests. The Full Faith and Credit Clause, U.S. CONST. art. IV, §1 and the Due Process Clause, U.S. CONST., amends. V and XIV, require California to duly take into account the policies of New York, New Jersey and other jurisdictions whose laws pertain to the underlying claims against Diasonics. *See, e.g., Hughes v. Fetter*, 341 U.S. 609 (1951); *Home Ins. Co. v. Dick*, 281 U.S. 397 (1930). Both the Full Faith and Credit Clause and the Due Process Clause must be enforced in California. U.S. CONST. art. VI, §2 (the Supremacy Clause). When the public policies of two or more states conflict, the federal constitution requires a state to yield

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[2] Indeed, private indemnity contracts, for example, provide defense only on a claim-by-claim basis, unlike insurance contracts. *Clement v. Consolidated Rail Corp.*,1991 WL 66791 (D.N.J. 1991).

to the greater governmental interest of its sister states, *Hughes*, 341 U.S. at 611-12, requires a state to acknowledge and respect its sister states' rights to declare certain contractual undertakings "invalid," *Dick*, 281 U.S. at 407, and thereby requires a state to yield to its sister states' policies.

Indeed, the underlying cases pending against Diasonics during the arbitration existed principally in other jurisdictions, namely New York and New Jersey. Future claims, those being the essence of the award, likewise would likely not be in California. These states do not allow parties to shift their potential fraud liability to others. *Austro v. Niagara Mohawk Power Corporation*, 487 N.E.2d 267 (N.Y. 1985); *Tryanowski v. Lodi Bd. of Educ.*, 643 A.2d 1057, 1062 (N.J. Super. Ct. 1994.).

As a federal court reaffirmed in *Stratton Group, Ltd. v. Sprayregan*, 466 F. Supp. 1180, 1185 n. 4 (S.D.N.Y. 1979), in a situation involving "common law fraud . . . for reason of public policy an intentional tortfeasor may not escape liability for his conduct by totally shifting it" even if the shift is to "a joint tortfeasor." That has always been and remains the law of common law jurisdictions such as New York. *Epstein v. Haas Securities Corp.*, 731 F. Supp. 1166, 1187 (S.D.N.Y. 1990). Common law jurisdictions have a long, unbroken history which forbids private indemnity for reckless and wilful misstatements. *See generally*, *Globus v. Law Research Service, Inc.*, 418 F.2d 1276, 1288 (2d Cir. 1969), *cert. denied*, 397 U.S. 913 (1970)(invalidating private indemnity agreement). "Generally, anyone who engages in a fraudulent scheme forfeits all right to protection, either at law or in equity." *Kansas City Operating Corp. v. Durwood*, 278 F.2d 354, 357 (8th Cir. 1960). "The principle of public policy is this: *Ex dolo mala non oritur actio*. (Out of fraud no action arises.) . . . . It is upon that ground the Court goes; not for the sake of the defendant, but because they will not lend their aid to such a plaintiff." *Holman v. Johnson*, 98 Eng. Rep. 1120, 1121 (1775) .

New York and New Jersey and certainly common law jurisdictions have strong, fundamental public policies against indemnity for intentional wrongdoing, fraud and punitive damages. Those states consider the obligation that an intentional tortfeasor or perpetrator of fraud bear the prospect of liability for his wrongdoing a necessity in terms of punishment and to effectively deter such conduct. Indemnifying Diasonics in advance of punishment for intentional and fraudulent conduct, which third party claimants against Diasonics assert caused them millions of dollars in damages, contravenes the common law of the jurisdictions where Diasonics committed its wrongs.

CONCLUSION

For all the foregoing reasons, Toshiba America's Petition For A Writ of Certiorari should be granted.

Dated: April 23, 1996

Respectfully submitted,

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